UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10 - Q

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED SEPTEMBER 30, 2018

1-2360

(Commission file number)

INTERNATIONAL BUSINESS MACHINES CORPORATION

(Exact name of registrant as specified in its charter)

New York (State of incorporation)	**13-0871985** (IRS employer identification number)
Armonk, New York (Address of principal executive offices)	**10504** (Zip Code)

914-499-1900

(Registrant s telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section l3 or l5(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act). o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The registrant had 908,793,777 shares of common stock outstanding at September 30, 2018.

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Part I - Financial Information

Item 1. Consolidated Financial Statements:

INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF EARNINGS

(UNAUDITED)

(Dollars in millions except per share amounts)	Three Months Ended September 30, 2018	2017	Nine Months Ended September 30, 2018	2017
Revenue:				
Services	$ 12,566	$ 12,703	$ 38,414	$ 37,592
Sales	5,800	6,017	18,221	17,744
Financing	389	433	1,195	1,260
Total revenue	18,756	19,153	57,830	56,597
Cost:				
Services	8,040	8,265*	25,519	25,034*
Sales	1,625	1,584*	5,216	4,779*
Financing	287	322	846	890
Total cost	9,953	10,172*	31,582	30,703*
Gross profit	8,803	8,981*	26,249	25,894*
Expense and other (income):				
Selling, general and administrative	4,363	4,606*	14,665	14,666*
Research, development and engineering	1,252	1,291*	4,021	4,212*
Intellectual property and custom development income	(275)	(308)	(842)	(1,118)
Other (income) and expense	275	159*	968	751*
Interest expense	191	168	530	451
Total expense and other (income)	5,807	5,917*	19,341	18,962*
Income from continuing operations before income taxes	2,996	3,065	6,908	6,931
Provision for income taxes	304	339	138	120
Income from continuing operations	$ 2,692	$ 2,726	$ 6,770	$ 6,811
Income/(loss) from discontinued operations, net of tax	2	0	7	(3)
Net income	$ 2,694	$ 2,726	$ 6,777	$ 6,807
Earnings/(loss) per share of common stock:				
Assuming dilution:				
Continuing operations	$ 2.94	$ 2.92	$ 7.36	$ 7.24
Discontinued operations	0.00	0.00	0.01	0.00
Total	$ 2.94	$ 2.92	$ 7.37	$ 7.24
Basic:				
Continuing operations	$ 2.95	$ 2.93	$ 7.39	$ 7.28
Discontinued operations	0.00	0.00	0.01	0.00
Total	$ 2.95	$ 2.93	$ 7.40	$ 7.28
Weighted-average number of common shares outstanding: (millions)				

Assuming dilution		915.2		933.2		920.0		940.2
Basic		911.2		929.4		915.6		935.6
Cash dividend per common share	$	1.57	$	1.50	$	4.64	$	4.40

* Recast to reflect adoption of the FASB guidance on presentation of net periodic pension and nonpension postretirement benefit costs.

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in millions)	**2018**	**2017**	**2018**	**2017**
Net income	$ 2,694	$ 2,726	$ 6,777	$ 6,807
Other comprehensive income/(loss), before tax:				
Foreign currency translation adjustments	(22)	89	(535)	213
Net changes related to available-for-sale securities:				
Unrealized gains/(losses) arising during the period	0	(1)	(2)	2
Reclassification of (gains)/losses to net income		0		1
Total net changes related to available-for-sale securities	0	(2)	(2)	2
Unrealized gains/(losses) on cash flow hedges:				
Unrealized gains/(losses) arising during the period	(46)	(70)	(134)	(198)
Reclassification of (gains)/losses to net income	28	(73)	408	(347)
Total unrealized gains/(losses) on cash flow hedges	(18)	(143)	274	(545)
Retirement-related benefit plans:				
Prior service costs/(credits)	0	0	(1)	0
Net (losses)/gains arising during the period	(1)	1	83	106
Curtailments and settlements	2	2	7	3
Amortization of prior service (credits)/costs	(18)	(22)	(55)	(66)
Amortization of net (gains)/losses	737	733	2,231	2,156
Total retirement-related benefit plans	719	713	2,264	2,200
Other comprehensive income/(loss), before tax	678	658	2,001	1,869
Income tax (expense)/benefit related to items of other comprehensive income	(209)	11	(807)	7
Other comprehensive income/(loss), net of tax	470	669	1,194	1,877
Total comprehensive income/(loss)	$ 3,164	$ 3,394	$ 7,970	$ 8,684

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(UNAUDITED)

ASSETS

(Dollars in millions)	At September 30, 2018	At December 31, 2017
Assets:		
Current assets:		
Cash and cash equivalents	$ 11,563	$ 11,972
Restricted cash	168	262*
Marketable securities	2,932	608
Notes and accounts receivable - trade (net of allowances of $310 in 2018 and $297 in 2017)	7,071	8,928
Short-term financing receivables (net of allowances of $273 in 2018 and $261 in 2017)	19,249	21,721
Other accounts receivable (net of allowances of $38 in 2018 and $36 in 2017)	767	981
Inventories, at lower of average cost or net realizable value:		
Finished goods	448	333
Work in process and raw materials	1,445	1,250
Total inventories	1,893	1,583
Deferred costs	2,227	1,820**
Prepaid expenses and other current assets	2,388	1,860* **
Total current assets	48,257	49,735
Property, plant and equipment	32,484	32,331
Less: Accumulated depreciation	21,535	21,215
Property, plant and equipment net	10,949	11,116
Long-term financing receivables (net of allowances of $52 in 2018 and $74 in 2017)	8,179	9,550
Prepaid pension assets	5,655	4,643
Deferred costs	2,581	2,136**
Deferred taxes	4,436	4,862
Goodwill	36,526	36,788
Intangible assets net	3,134	3,742
Investments and sundry assets	2,272	2,783**
Total assets	$ 121,990	$ 125,356

* Recast to reflect adoption of the FASB guidance on restricted cash.

** Recast to conform to current period presentation.

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)

(UNAUDITED)

LIABILITIES AND EQUITY

(Dollars in millions)	**At September 30, 2018**	**At December 31, 2017**
Liabilities:		
Current liabilities:		
Taxes	$ 2,502	$ 4,219
Short-term debt	10,932	6,987
Accounts payable	5,384	6,451
Compensation and benefits	3,601	3,644
Deferred income	10,704	11,552
Other accrued expenses and liabilities	3,700	4,510
Total current liabilities	36,822	37,363
Long-term debt	35,989	39,837
Retirement and nonpension postretirement benefit obligations	15,774	16,720
Deferred income	3,507	3,746
Other liabilities	9,979	9,965
Total liabilities	102,071	107,631
Equity:		
IBM stockholders equity:		
Common stock, par value $0.20 per share, and additional paid-in capital	54,987	54,566
Shares authorized: 4,687,500,000		
Shares issued: 2018 - 2,232,637,802 2017 - 2,229,428,813		
[redacted]		
Treasury stock - at cost	(165,995)	(163,507)
[redacted]		
Accumulated other comprehensive income/(loss)	(27,820)	(26,592)
Total IBM stockholders equity	19,784	17,594
Noncontrolling interests	134	131
Total equity	19,918	17,725
Total liabilities and equity	$ 121,990	$ 125,356

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

(Dollars in millions)	Nine Months Ended September 30, 2018	2017
Cash flows from operating activities:		
Net income	$ 6,777	$ 6,807
Adjustments to reconcile net income to cash provided by operating activities		
Depreciation	2,337	2,231
Amortization of intangibles	1,031	1,161
Stock-based compensation	371	388
Net (gain)/loss on asset sales and other	(18)	92
Changes in operating assets and liabilities, net of acquisitions/divestitures	631	312
Net cash provided by operating activities	11,128	10,991
Cash flows from investing activities:		
Payments for property, plant and equipment	(2,613)	(2,273)
Proceeds from disposition of property, plant and equipment	192	337
Investment in software	(418)	(411)
Acquisition of businesses, net of cash acquired	(123)	(442)
Divestitures of businesses, net of cash transferred		35
Non-operating finance receivables net	377	469
Purchases of marketable securities and other investments	(6,024)	(3,764)*
Proceeds from disposition of marketable securities and other investments	3,241	2,778
Net cash used in investing activities	(5,368)	(3,271)*
Cash flows from financing activities:		
Proceeds from new debt	4,714	9,355
Payments to settle debt	(4,246)	(6,252)
Short-term borrowings/(repayments) less than 90 days net	376	(794)
Common stock repurchases	(2,393)	(3,674)
Common stock repurchases for tax withholdings	(148)	(153)
Financing other	82	137
Cash dividends paid	(4,250)	(4,119)
Net cash used in financing activities	(5,864)	(5,499)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(399)	875
Net change in cash, cash equivalents and restricted cash	(503)	3,096*
Cash, cash equivalents and restricted cash at January 1	12,234	8,073*
Cash, cash equivalents and restricted cash at September 30	$ 11,731	$ 11,168*

* Recast to reflect adoption of the FASB guidance on restricted cash.

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(UNAUDITED)

(Dollars in millions)	Common Stock and Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total IBM Stockholders Equity	Non-Controlling Interests	Total Equity
Equity - January 1, 2018	$ 54,566	$ 153,126	$ (163,507)	$ (26,592)	$ 17,594	$ 131	$ 17,725
Cumulative effect of change in accounting principle:							
Revenue		524			524		524
Stranded tax effects/other *		2,422		(2,422)			
Net income plus other comprehensive income/(loss):							
Net income		6,777			6,777		6,777
Other comprehensive income/(loss)				1,194	1,194		1,194
Total comprehensive income/(loss)					$ 7,970		$ 7,970
Cash dividends paid common stock ($4.64 per share)		(4,250)			(4,250)		(4,250)
Common stock issued under employee plans (3,208,989 shares)	421				421		421
Purchases (978,004 shares) and sales (365,600 shares) of treasury stock under employee plans net		13	(101)		(89)		(89)
Other treasury shares purchased, not retired (15,982,033 shares)			(2,388)		(2,388)		(2,388)
Changes in noncontrolling interests						3	3
Equity - September 30, 2018	$ 54,987	$ 158,612	$ (165,995)	$ (27,820)	$ 19,784	$ 134	$ 19,918

* Reflects the adoption of the FASB guidance on stranded tax effects, hedging and financial instruments. Refer to note 2, Accounting Changes .

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (CONTINUED)
(UNAUDITED)

(Dollars in millions)	Common Stock and Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total IBM Stockholders Equity	Non-Controlling Interests	Total Equity
Equity - January 1, 2017	$ 53,935	$ 152,759	$ (159,050)	$ (29,398)	$ 18,246	$ 146	$ 18,392
Cumulative effect of change in accounting principle *		102			102		102
Net income plus other comprehensive income/(loss):							
Net income		6,807			6,807		6,807
Other comprehensive income/(loss)				1,877	1,877		1,877
Total comprehensive income/(loss)					$ 8,684		$ 8,684
Cash dividends paid common stock ($4.40 per share)		(4,119)			(4,119)		(4,119)
Common stock issued under employee plans (3,372,586 shares)	460				460		460
Purchases (960,186 shares) and sales (363,335 shares) of treasury stock under employee plans net		15	(106)		(91)		(91)
Other treasury shares purchased, not retired (22,851,760 shares)			(3,655)		(3,655)		(3,655)
Changes in noncontrolling interests						(16)	(16)
Equity - September 30, 2017	$ 54,395	$ 155,565	$ (162,812)	$ (27,521)	$ 19,627	$ 130	$ 19,757

* Reflects the adoption of the FASB guidance on intra-entity transfers of assets.

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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Notes to Consolidated Financial Statements:

1. Basis of Presentation: The accompanying Consolidated Financial Statements and footnotes of the International Business Machines Corporation (IBM or the company) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The financial statements and footnotes are unaudited. In the opinion of the company s management, these statements include all adjustments, which are only of a normal recurring nature, necessary to present a fair statement of the company s results of operations, financial position and cash flows.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amount of assets, liabilities, revenue, costs, expenses and other comprehensive income/(loss) that are reported in the Consolidated Financial Statements and accompanying disclosures. These estimates are based on management s best knowledge of current events, historical experience, actions that the company may undertake in the future and on various other assumptions that are believed to be reasonable under the circumstances. As a result, actual results may be different from these estimates. For a discussion of significant estimates and judgments made in recognizing revenue under the revenue standard effective January 1, 2018, see note 3, Revenue Recognition . Also, refer to the company s 2017 Annual Report on pages 70 to 73, for a discussion of the company s critical accounting estimates.

Noncontrolling interest amounts of $6.2 million and $4.4 million, net of tax, for the three months ended September 30, 2018 and 2017, respectively, and $17.9 million and $11.5 million, net of tax, for the nine months ended September 30, 2018 and 2017, respectively, are included as a reduction within other (income) and expense in the Consolidated Statement of Earnings.

Interim results are not necessarily indicative of financial results for a full year. The information included in this Form 10-Q should be read in conjunction with the company s 2017 Annual Report.

Within the financial statements and tables presented, certain columns and rows may not add due to the use of rounded numbers for disclosure purposes. Percentages presented are calculated from the underlying whole-dollar amounts. Certain prior year amounts have been reclassified to conform to the current year presentation. This is annotated where applicable.

2. Accounting Changes:

New Standards to be Implemented

In August 2018, the Financial Accounting Standards Board (FASB) issued guidance on a customer s accounting for implementation costs incurred in cloud-computing arrangements that are hosted by a vendor. Certain types of implementation costs should be capitalized and amortized over the term of the hosting arrangement. The guidance is effective January 1, 2020 and early adoption is permitted. The company will adopt the guidance on January 1, 2019 on a prospective basis, and does not expect the guidance to have a material impact on the consolidated financial results.

In August 2018, the FASB issued guidance which changes the disclosure requirements for fair value measurements and defined benefit plans. The guidance is effective for each of the topics on January 1, 2020 and January 1, 2021, respectively, with early adoption of certain provisions permitted. As a result, the company has removed Level 1/Level 2 transfer disclosures in the third-quarter 2018 in accordance with the fair value guidance. The company is evaluating the adoption date for the remaining changes. As the guidance is a change to disclosures only, the company does not expect the guidance to have a material impact on the consolidated financial results.

In June 2016, the FASB issued guidance for credit impairment based on an expected loss model rather than an incurred loss model. The guidance requires the consideration of all available relevant information when estimating expected credit losses, including past events, current conditions and forecasts and their implications for expected credit losses. A cross-functional team has been established that is evaluating the financial instruments portfolio and system, process and policy change requirements. The new guidance expands the scope of financial instruments subject to impairment, including off-balance sheet commitments and residual value. The guidance is effective January 1, 2020 with one-year early adoption permitted and the company is continuing to evaluate the impact of the new guidance and adoption date.

The FASB issued guidance in February 2016, with amendments in 2018, which changes the accounting for leases. The guidance requires lessees to recognize right-of-use assets and lease liabilities for most leases in the Consolidated Statement of Financial Position. The guidance makes some changes to lessor accounting, including the elimination of the use of third-party residual value guarantee insurance in the lease classification test, and overall aligns with the new revenue recognition guidance. The guidance also requires qualitative and quantitative disclosures to assess the amount, timing and uncertainty of cash flows arising from leases. The guidance is effective January 1, 2019 and early adoption is permitted. The company will

Notes to Consolidated Financial Statements (continued)

adopt the guidance as of the effective date and will apply the transition option, whereby prior comparative periods will not be retrospectively presented in the consolidated financial statements. The company expects to elect the package of practical expedients not to reassess prior conclusions related to contracts containing leases, lease classification and initial direct costs and the lessee practical expedient to combine lease and nonlease components for all asset classes. The company will make a policy election to not recognize right-of-use assets and lease liabilities for short-term leases for all asset classes. The other practical expedients available under the guidance are being evaluated.

A cross-functional implementation team is evaluating the lease portfolio, system, process, control and policy change requirements. The company has made significant progress in these areas as well as in gathering the necessary data elements for the lease population. A system provider has been selected, with system configuration, testing and implementation underway. The company continues to evaluate the impact of the new guidance on its consolidated financial results and expects it will have a material impact on the Consolidated Statement of Financial Position. As a lessee, the company s operating lease commitments were $6.6 billion at December 31, 2017.

From a lessor perspective, due to changes in lease termination guidance, when equipment is returned to the company prior to the end of the lease term, the carrying amounts of lease receivables, which remain outstanding relating to that equipment and still expected to be collected, will be reclassified to loan receivables. The amount that would have been reclassified from lease receivables to loan receivables in 2017, under the application of this new guidance, would have been approximately $450 million. Additionally, the company does not expect the removal of third-party residual value guarantee insurance in the lease classification test to have a material impact on the Consolidated Statement of Earnings.

The company continues to assess the potential impacts of the guidance, including changes to the guidance expected to be issued by the FASB, normal and ongoing business dynamics or potential changes in contracting terms, and as a result, preliminary conclusions are subject to change.

Standards Implemented

In February 2018, the FASB issued guidance that allows entities to elect an option to reclassify the stranded tax effects related to the application of the Tax Cuts and Jobs Act (U.S. tax reform) from accumulated other comprehensive income/(loss) (AOCI) to retained earnings. The guidance is effective January 1, 2019 with early adoption permitted, and can be applied either in the period of adoption or retrospectively to all applicable periods. The company adopted the guidance effective January 1, 2018, and elected not to reclassify prior periods. In accordance with its accounting policy, the company releases income tax effects from AOCI once the reason the tax effects were established cease to exist (e.g., when available-for-sale debt securities are sold or if a pension plan is liquidated). This guidance allows for the reclassification of stranded tax effects as a result of the change in tax rates from U.S. tax reform to be recorded upon adoption of the guidance rather than at an actual cessation date. At adoption on January 1, 2018, $2,420 million was reclassified from AOCI to retained earnings, primarily comprised of amounts relating to retirement-related benefit plans.

In August 2017, the FASB issued guidance to simplify the application of hedge accounting in certain areas, better portray the economic results of an entity s risk management activities in its financial statements and make targeted improvements to presentation and disclosure requirements. The guidance is effective January 1, 2019 with early adoption permitted. The company adopted the guidance as of January 1, 2018, and it did not have a material impact in the consolidated financial results.

In March 2017, the FASB issued guidance that impacts the presentation of net periodic pension and postretirement benefit costs (net benefit cost   ). Under the guidance, the service cost component of net benefit cost continues to be presented within cost, selling, general and administrative expense and research, development and engineering expense in the Consolidated Statement of Earnings, unless eligible for capitalization. The other components of net benefit cost are presented separately from service cost within other (income) and expense in the Consolidated Statement of Earnings. The guidance was effective January 1, 2018 with early adoption permitted. The company adopted the guidance as of the effective date. The guidance is primarily a change in financial statement presentation and did not have a material impact in the consolidated financial results. This presentation change was applied retrospectively upon adoption. For the three months ended September 30, 2017, $181 million, $42 million, and $51 million was recast from total cost, selling, general and administrative (SG&A) expense, and research, development, and engineering (RD&E) expense, respectively, into other (income) and expense. For the nine months ended September 30, 2017, $529 million, $293 million, and $148 million was recast from total cost, SG&A expense, and RD&E expense, respectively, into other (income) and expense. Refer to note 9,   Retirement-Related Benefits,   for additional information.

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Notes to Consolidated Financial Statements (continued)

In January 2016, the FASB issued guidance which addresses aspects of recognition, measurement, presentation and disclosure of financial instruments. The guidance was effective January 1, 2018 and early adoption was not permitted except for limited provisions. The company adopted the guidance on the effective date. Certain equity investments are now measured at fair value with changes recognized in net income. The amendment also simplified the impairment test of equity investments that lack readily determinable fair value. The guidance did not have a material impact in the consolidated financial results.

The FASB issued guidance on the recognition of revenue from contracts with customers in May 2014 with amendments in 2015 and 2016. Revenue recognition depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires specific disclosures relating to revenue recognition. The company adopted the guidance effective January 1, 2018 using the modified retrospective transition method. At adoption, $557 million was reclassified from notes and accounts receivable-trade and deferred income-current to prepaid expenses and other current assets to establish the opening balance for net contract assets. In-scope sales commission costs previously recorded in the Consolidated Statement of Earnings were capitalized in deferred costs in accordance with the transition guidance, in the amount of $737 million. Deferred income of $29 million was recorded for certain software licenses that will be recognized over time versus at a point in time under previous guidance. Additionally, net deferred taxes were reduced by $184 million in the Consolidated Statement of Financial Position, resulting in a cumulative-effect net increase to retained earnings of $524 million. The guidance did not have a material impact in the company s consolidated financial results for the three and nine months ended September 30, 2018. The company expects revenue recognition for its broad portfolio of hardware, software, and services offerings to remain largely unchanged. Refer to note 3, Revenue Recognition, for additional information, including further discussion on the impact of adoption and changes in accounting policies relating to revenue recognition.

In January 2017, the FASB issued guidance which clarifies the definition of a business. The guidance provides a more robust framework to use in determining when a set of assets and activities acquired or sold is a business. The guidance was effective January 1, 2018 and early adoption was permitted. The company adopted the guidance effective January 1, 2017, and it did not have a material impact in the consolidated financial results.

In October 2016, the FASB issued guidance which requires an entity to recognize the income tax consequences of intra-entity transfers of assets, other than inventory, at the time of transfer. Assets within the scope of the guidance include intellectual property and property, plant and equipment. The guidance was effective January 1, 2018 and early adoption was permitted. The company adopted the guidance on January 1, 2017 using the required modified retrospective method. At adoption, $95 million and $47 million were reclassified from investments and sundry assets and prepaid expenses and other current assets, respectively into retained earnings. Additionally, net deferred taxes of $244 million were established in deferred taxes in the Consolidated Statement of Financial Position, resulting in a cumulative-effect net increase to retained earnings of $102 million. In January 2017, the company had one transaction that generated a $582 million benefit to income tax expense, income from continuing operations and net income and a benefit to both basic and diluted earnings per share of $0.62 per share for the nine months ended September 30, 2017. No transactions impacted the consolidated financial results for the nine months ended September 30, 2018. The ongoing impact of this guidance will be dependent on any transaction that is within its scope.

In March 2016, the FASB issued guidance which changes the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification in the Consolidated Statement of Cash Flows. The guidance was effective and adopted by the company on January 1, 2017, and it did not have a material impact in the Consolidated Statement of Financial Position. The ongoing impact of the guidance could result in increased volatility in the provision for income taxes and earnings per share in the Consolidated Statement of Earnings, depending on the company s share price at exercise or vesting of share-based awards compared to grant date, however these impacts are not expected to be material. These impacts are recorded on a prospective basis. The company continues to estimate forfeitures in conjunction with measuring stock-based compensation cost. The guidance also requires cash payments on behalf of employees for shares directly withheld for taxes to be presented as financing outflows in the Consolidated Statement of Cash Flows. The FASB also issued guidance in May 2017 and June 2018, which relates to the accounting for modifications of share-based payment awards and accounting for share-based payments issued to non-employees, respectively. The company adopted the guidance for modifications in the second quarter of 2017, and guidance for non-employees payments in the second quarter of 2018. The guidance had no impact in the consolidated financial results.

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Notes to Consolidated Financial Statements (continued)

3. Revenue Recognition: Effective January 1, 2018, the company adopted the new accounting standard related to the recognition of revenue in contracts with customers under the modified retrospective transition method. This method was applied to contracts that were not complete as of the date of initial application. The following is a summary of new and/or revised significant accounting policies, which relate primarily to revenue and cost recognition. Refer to note A, Significant Accounting Policies, in the company s 2017 Annual Report for the policies in effect for revenue and cost prior to January 1, 2018 and for all other significant accounting policies. The impact related to adopting the new standard was not material. For further information regarding the adoption of the new standard, see note 2, Accounting Changes .

Revenue

The company accounts for a contract with a client when it has written approval, the contract is committed, the rights of the parties, including payment terms, are identified, the contract has commercial substance and consideration is probable of collection.

Revenue is recognized when, or as, control of a promised product or service transfers to a client, in an amount that reflects the consideration to which the company expects to be entitled in exchange for transferring those products or services. If the consideration promised in a contract includes a variable amount, the company estimates the amount to which it expects to be entitled using either the expected value or most likely amount method. The company s contracts may include terms that could cause variability in the transaction price, including, for example, rebates, volume discounts, service-level penalties, and performance bonuses or other forms of contingent revenue.

The company only includes estimated amounts in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. The company may not be able to reliably estimate contingent revenue in certain long-term arrangements due to uncertainties that are not expected to be resolved for a long period of time or when the company s experience with similar types of contracts is limited. The company s arrangements infrequently include contingent revenue. Estimates of variable consideration and the determination of whether to include estimated amounts in the transaction price are based on all information (historical, current and forecasted) that is reasonably available to the company, taking into consideration the type of client, the type of transaction and the specific facts and circumstances of each arrangement. Changes in estimates of variable consideration are included in the disclosure on pages 20 and 21.

The company s standard billing terms are that payment is due upon receipt of invoice, payable within 30 days. Invoices are generally issued as control transfers and/or as services are rendered. Additionally, in determining the transaction price, the company adjusts the promised amount of consideration for the effects of the time value of money if the billing terms are not standard and the timing of payments agreed to by the parties to the contract provide the client or the company with a significant benefit of financing, in which case the contract contains a significant financing component. As a practical expedient, the company does not account for significant financing components if the period between when the company transfers the promised product or service to the client and when the client pays for that product or service will be one year or less. Most arrangements that contain a financing component are financed through the company s Global Financing business and include explicit financing terms.

The company may include subcontractor services or third-party vendor equipment or software in certain integrated services arrangements. In these types of arrangements, revenue from sales of third-party vendor products or services is recorded net of costs when the company is acting as an agent between the client and the vendor, and gross when the company is the principal for the transaction. To determine whether the company is an agent or principal, the company considers whether it obtains control of the products or services before they are transferred to the customer. In making this evaluation, several factors are considered, most notably whether the company has primary responsibility for fulfillment to the client, as well as inventory risk and pricing discretion.

The company recognizes revenue on sales to solution providers, resellers and distributors (herein referred to as resellers) when the reseller has economic substance apart from the company and the reseller is considered the principal for the transaction with the end-user client.

The company reports revenue net of any revenue-based taxes assessed by governmental authorities that are imposed on and concurrent with specific revenue-producing transactions.

In addition to the aforementioned general policies, the following are the specific revenue recognition policies for arrangements with multiple performance obligations and for each major category of revenue.

Notes to Consolidated Financial Statements (continued)

Arrangements with Multiple Performance Obligations

The company s global capabilities as a cognitive solutions and cloud platform company include services, software, hardware and related financing. The company enters into revenue arrangements that may consist of any combination of these products and services based on the needs of its clients. For example, a client may purchase a server that includes operating system software. In addition, the arrangement may include post-contract support for the software and a contract for post-warranty maintenance service for the hardware. These types of arrangements may also include financing provided by the company. These arrangements consist of multiple products and services, whereby the hardware and software may be delivered in one period and the software support and hardware maintenance services are delivered over time. In another example, the company may assist the client in building and running an enterprise information technology (IT) environment utilizing a private cloud on a long-term basis and the client periodically purchases hardware and/or software products from the company to upgrade or expand the facility. The services delivered on the cloud are provided on a continuous basis across multiple reporting periods, and the hardware and software products are provided in each period the products are purchased.

The company continues to build new products and offerings and continuously reinvent its platforms and delivery methods, including through the use of cloud and as-a-Service models. These are not separate businesses; they are offerings across the segments that address market opportunities in analytics, data, cloud and security. Revenue from these offerings follows the specific revenue recognition policies for arrangements with multiple performance obligations and for each major category of revenue, depending on the type of offering, which are comprised of services, hardware and/or software.

To the extent that a product or service in multiple performance obligation arrangements is subject to other specific accounting guidance, such as leasing guidance, that product or service is accounted for in accordance with such specific guidance. For all other products or services in these arrangements, the criteria below are considered to determine when the products or services are distinct and how to allocate the arrangement consideration to each distinct performance obligation. A performance obligation is a promise in a contract with a client to transfer products or services that are distinct. If the company enters into two or more contracts at or near the same time, the contracts may be combined and accounted for as one contract, in which case the company determines whether the products or services in the combined contract are distinct. A product or service that is promised to a client is distinct if both of the following criteria are met:

- The client can benefit from the product or service either on its own or together with other resources that are readily available to the client (that is, the product or service is capable of being distinct); and

- The company s promise to transfer the product or service to the client is separately identifiable from other promises in the contract (that is, the product or service is distinct within the context of the contract).

If these criteria are not met, the company determines an appropriate measure of progress based on the nature of its overall promise for the single performance obligation. When products and services are distinct, the arrangement consideration is allocated to each performance obligation on a relative standalone selling price basis. The revenue policies in the Services, Hardware and/or Software sections below are then applied to each performance obligation, as applicable.

To the extent the company grants the customer the option to acquire additional products or services in one of these arrangements, the company accounts for the option as a distinct performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into the contract (e.g., a discount incremental to the range of discounts typically given for the product or service), in which case the client in effect pays in advance for the option to purchase future products or services. The company recognizes revenue when those future products or services are transferred or when the option expires.

Services

The company s primary services offerings include infrastructure services, including outsourcing, and other managed services; application management services; global process services (GPS); maintenance and support; and consulting, including the design and development of complex IT systems to a client s specifications (e.g., design and build). Many of these services can be delivered entirely or partially through cloud or as-a-Service delivery models. The company s services are provided on a time-and-material basis, as a fixed-price contract or as a fixed-price per measure of output contract and the contract terms range from less than one year to over 10 years.

In services arrangements, the company typically satisfies the performance obligation and recognizes revenue over time. In design and build arrangements, the performance obligation is satisfied over time either because the client controls the asset as it is created (e.g., when the asset is built at the customer site) or because the company s performance does not create an

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Notes to Consolidated Financial Statements (continued)

asset with an alternative use and the company has an enforceable right to payment plus a reasonable profit for performance completed to date. In most other services arrangements, the performance obligation is satisfied over time because the client simultaneously receives and consumes the benefits provided as the company performs the services.

In outsourcing, other managed services, application management, GPS and other cloud-based services arrangements, the company determines whether the services performed during the initial phases of the arrangement, such as setup activities, are distinct. In most cases, the arrangement is a single performance obligation comprised of a series of distinct services that are substantially the same and that have the same pattern of transfer (i.e., distinct days of service). The company applies a measure of progress (typically time-based) to any fixed consideration and allocates variable consideration to the distinct periods of service based on usage. As a result, revenue is generally recognized over the period the services are provided on a usage basis. This results in revenue recognition that corresponds with the value to the client of the services transferred to date relative to the remaining services promised.

Revenue from time-and-material contracts is recognized on an output basis as labor hours are delivered and/or direct expenses are incurred. Revenue from as-a-Service type contracts, such as Infrastructure-as-a-Service, is recognized either on a straight-line basis or on a usage basis, depending on the terms of the arrangement (such as whether the company is standing ready to perform or whether the contract has usage-based metrics). If the as-a-Service contract includes setup activities, those promises in the arrangement are evaluated to determine if they are distinct.

Revenue related to maintenance and support services and extended warranty is recognized on a straight-line basis over the period of performance because the company is standing ready to provide services.

In fixed-price design and build contracts, revenue is recognized based on progress towards completion of the performance obligation using a cost-to-cost measure of progress (i.e., percentage-of-completion (POC) method of accounting). Revenue is recognized based on the labor costs incurred to date as a percentage of the total estimated labor costs to fulfill the contract. Due to the nature of the work performed in these arrangements, the estimation of cost at completion is complex, subject to many variables and requires significant judgment. Key factors reviewed by the company to estimate costs to complete each contract are future labor and product costs and expected productivity efficiencies. If circumstances arise that change the original estimates of revenues, costs, or extent of progress toward completion, revisions to the estimates are made. These revisions may result in increases or decreases in estimated revenues or costs, and such revisions are reflected in revenue on a cumulative catch-up basis in the period in which the circumstances that gave rise to the revision become known by the company. Refer to page 21 for the amount of revenue recognized in the reporting period on a cumulative catch-up basis (i.e., from performance obligations satisfied, or partially satisfied, in previous periods).

The company performs ongoing profitability analyses of its design and build services contracts accounted for using a cost-to-cost measure of progress in order to determine whether the latest estimates of revenues, costs and profits require updating. If at any time these estimates indicate that the contract will be unprofitable, the entire estimated loss for the remainder of the contract is recorded immediately. For other types of services contracts, any losses are recorded as incurred.

In some services contracts, the company bills the client prior to recognizing revenue from performing the services. In other services contracts, the company performs the services prior to billing the client. When the company performs services prior to billing the client in design and build contracts, the right to consideration is typically subject to milestone completion or client acceptance and the unbilled accounts receivable is classified as a contract asset. Refer to page 85 of the company s 2017 Annual Report for the amount of deferred income and unbilled accounts receivable at December 31, 2017 and 2016.

Billings usually occur in the month after the company performs the services or in accordance with specific contractual provisions.

Hardware

The company s hardware offerings include the sale or lease of system servers and storage solutions. These products can also be delivered through as-a-Service or cloud delivery models, such as Storage-as-a-Service. The company also offers installation services for its more complex hardware products. Hardware offerings are often sold with distinct maintenance services, described under the Services section above.

Revenue from hardware sales is recognized when control has transferred to the customer which typically occurs when the hardware has been shipped to the client, risk of loss has transferred to the client and the company has a present right to payment for the hardware. In limited circumstances when a hardware sale includes client acceptance provisions, revenue is recognized either when client acceptance has been obtained, client acceptance provisions have lapsed, or the company has

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Notes to Consolidated Financial Statements (continued)

objective evidence that the criteria specified in the client acceptance provisions have been satisfied. Revenue from hardware sales-type leases is recognized at the beginning of the lease term. Revenue from rentals and operating leases is recognized on a straight-line basis over the term of the rental or lease.

Revenue from as-a-Service arrangements is recognized either on a straight-line basis or on a usage basis as described in the Services section above. Installation services are accounted for as distinct performance obligations with revenue recognized as the services are performed. Any cost of standard warranties is accrued when the corresponding revenue is recognized. Shipping and handling activities that occur after the client has obtained control of a product are accounted for as an activity to fulfill the promise to transfer the product rather than as an additional promised service and, therefore, no revenue is deferred and recognized over the shipping period.

Software

The company s software offerings include solutions software, which contains many of the company s strategic areas including analytics, data and security; transaction processing software, which primarily runs mission-critical systems for clients; integration software, which helps clients to create, connect and optimize their applications data and infrastructure; and, operating systems software, which provides operating systems for IBM Z and Power Systems hardware. Many of these offerings can be delivered entirely or partially through as-a-Service or cloud delivery models, while others are delivered as on-premise software licenses.

Revenue from perpetual (one-time charge) license software is recognized at a point in time at the inception of the arrangement when control transfers to the client, if the software license is distinct from the post-contract support offered by the company. In limited circumstances, when the software requires continuous updates to provide the intended functionality, the software license and post-contract support are not distinct and revenue for the single performance obligation is recognized over time as the post-contract support is provided. This is only applicable to certain security software perpetual licenses offered by the company. Prior to the adoption of the new revenue standard, the company recognized revenue for these software licenses at a point in time at the inception of the arrangement. This change did not have a material impact on the company s financial statements.

Revenue from post-contract support is recognized over the contract term on a straight-line basis because the company is providing a service of standing ready to provide support, when-and-if needed, and is providing unspecified software upgrades on a when-and-if available basis over the contract term.

Revenue from software hosting or Software-as-a-Service arrangements is recognized either on a straight-line basis or on a usage basis as described in the Services section above. In software hosting arrangements, the rights provided to the client (e.g., ownership of a license, contract termination provisions and the feasibility of the client to operate the software) are considered in determining whether the arrangement includes a license. In arrangements that include a software license, the associated revenue is recognized in accordance with the software license recognition policy above rather than over time as a service.

Revenue from term license software is recognized at a point in time for the committed term of the contract (which is typically one month due to client termination rights). However, if the amount of consideration to be paid in exchange for the license depends on client usage, revenue is recognized when the usage occurs.

Financing

Financing income attributable to sales-type leases, direct financing leases and loans is recognized on the accrual basis using the effective interest method. Operating lease income is recognized on a straight-line basis over the term of the lease.

Standalone Selling Price

The company allocates the transaction price to each performance obligation on a relative standalone selling price basis. The standalone selling price (SSP) is the price at which the company would sell a promised product or service separately to a client. In most cases, the company is able to establish SSP based on the observable prices of products or services sold separately in comparable circumstances to similar clients. The company typically establishes a standalone selling price range for its products and services which are reassessed on a periodic basis or when facts and circumstances change.

In certain instances, the company may not be able to establish a standalone selling price range based on observable prices and the company estimates the standalone selling price. The company estimates SSP by considering multiple factors

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Notes to Consolidated Financial Statements (continued)

including, but not limited to, overall market conditions, including geographic or regional specific factors, competitive positioning, competitor actions, internal costs, profit objectives and pricing practices. Additionally, in certain circumstances, the company may estimate SSP for a product or service by applying the residual approach. This approach has been most commonly used when certain perpetual software licenses are only sold bundled with one year of post-contract support and a price has not been established for the software. Estimating SSP is a formal process that includes review and approval by the company s management.

Services Costs

Recurring operating costs for services contracts are recognized as incurred. For fixed-price design and build contracts, the costs of external hardware and software accounted for under the cost-to-cost measure of progress are deferred and recognized based on the labor costs incurred to date (i.e., the measure of progress), as a percentage of the total estimated labor costs to fulfill the contract as control transfers over time for these performance obligations. Certain eligible, nonrecurring costs incurred in the initial phases of outsourcing contracts and other cloud-based services contracts (i.e., setup costs) are capitalized when the costs relate directly to the contract, the costs generate or enhance resources of the company that will be used in satisfying the performance obligation in the future, and the costs are expected to be recovered. These costs consist of transition and setup costs related to the installation of systems and processes and other deferred fulfillment costs, including, prepaid assets used in services contracts (i.e., prepaid software or prepaid maintenance), and other deferred fulfillment costs eligible for capitalization. Capitalized costs are amortized on a straight-line basis over the expected period of benefit, which includes anticipated contract renewals or extensions, consistent with the transfer to the client of the services to which the asset relates. Additionally, fixed assets associated with these contracts are capitalized and depreciated on a straight-line basis over the expected useful life of the asset. If an asset is contract specific, then the depreciation period is the shorter of the useful life of the asset or the contract term. Amounts paid to clients in excess of the fair value of acquired assets used in outsourcing arrangements are deferred and amortized on a straight-line basis as a reduction of revenue over the expected period of benefit. The company performs periodic reviews to assess the recoverability of deferred contract transition and setup costs. This review is done by comparing the carrying amount of the asset to the remaining amount of consideration the company expects to receive for the services to which the asset relates, less the costs that relate directly to providing those services that have not yet been recognized. If the carrying amount is deemed not recoverable, an impairment loss is recognized.

In situations in which an outsourcing contract is terminated, the terms of the contract may require the client to reimburse the company for the recovery of unbilled accounts receivable, unamortized deferred costs incurred to purchase specific assets utilized in the delivery of services and to pay any additional costs incurred by the company to transition the services.

Software Costs

Certain eligible, non-recurring costs incurred in the initial phases of Software-as-a-Service contracts are deferred and amortized over the expected period of benefit, which includes anticipated contract renewals or extensions, consistent with the policy described for Services Costs. Recurring operating costs in these contracts are recognized as incurred.

Incremental Costs of Obtaining a Contract

Incremental costs of obtaining a contract (e.g., sales commissions) are capitalized and amortized on a straight-line basis over the expected customer relationship period if the company expects to recover those costs. The company previously expensed these costs as incurred. The expected customer relationship is determined based on the average customer relationship period, including expected renewals, for each offering type and ranges from three to six years. Expected renewal periods are only included in the expected customer relationship period if commission amounts paid upon renewal are not commensurate with amounts paid on the initial contract. Incremental costs of obtaining a contract include only those costs the company incurs to obtain a contract that it would not have incurred if the contract had not been obtained. The company has determined that certain commissions programs meet the requirements to be capitalized. Some commission programs are not subject to capitalization as the commission expense is paid and recognized as the related revenue is recognized. Additionally, as a practical expedient, the company expenses costs to obtain a contract as incurred if the amortization period would have been a year or less. These costs are included in selling, general and administrative expenses.

Product Warranties

The company offers warranties for its hardware products that generally range up to three years, with the majority being either one or three years. Estimated costs for standard warranty terms are recognized when revenue is recorded for the related product. The company estimates its warranty costs standard to the product based on historical warranty claim experience and

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Notes to Consolidated Financial Statements (continued)

estimates of future spending, and applies this estimate to the revenue stream for products under warranty. Estimated future costs for warranties applicable to revenue recognized in the current period are charged to cost of sales. The warranty liability is reviewed quarterly to verify that it properly reflects the remaining obligation based on the anticipated expenditures over the balance of the obligation period. Adjustments are made when actual warranty claim experience differs from estimates. Costs from fixed-price support or maintenance contracts, including extended warranty contracts, are recognized as incurred.

Revenue from extended warranty contracts is initially recorded as deferred income and subsequently recognized on a straight-line basis over the delivery period because the company is providing a service of standing ready to provide services over such term.

Contract Assets and Notes and Accounts Receivable Trade

The company classifies the right to consideration in exchange for products or services transferred to a client as either a receivable or a contract asset. A receivable is a right to consideration that is unconditional as compared to a contract asset which is a right to consideration that is conditional upon factors other than the passage of time. The majority of the company s contract assets represent unbilled amounts related to design and build services contracts when the cost-to-cost method of revenue recognition is utilized, revenue recognized exceeds the amount billed to the client, and the right to consideration is subject to milestone completion or client acceptance. Contract assets are generally classified as current and are recorded on a net basis with deferred income (i.e., contract liabilities) at the contract level. At January 1, 2018 and September 30, 2018 contract assets of $557 million and $510 million, respectively, are included in prepaid expenses and other current assets in the Consolidated Statement of Financial Position. At December 31, 2017, these assets were classified as notes and accounts receivable-trade in the Consolidated Statement of Financial Position.

An allowance for contract assets, if needed, and uncollectible trade receivables is estimated based on a combination of write-off history, aging analysis and any specific, known troubled accounts.

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Notes to Consolidated Financial Statements (continued)

Disaggregation of Revenue

The following tables provide details of revenue by major products/service offerings and by geography.

Revenue by Major Products/Service Offerings

(Dollars in millions) For the three months ended September 30, 2018:	Cognitive Solutions	Global Business Services	Technology Services & Cloud Platforms	Systems	Global Financing	Other	Total Revenue
Solutions Software	$ 2,910	$	$	$	$	$	$ 2,910
Transaction Processing Software	1,238						1,238
Consulting		1,900					1,900
Global Process Services		314					314
Application Management		1,915					1,915
Infrastructure Services			5,595				5,595
Technical Support Services			1,707				1,707
Integration Software			990				990
Systems Hardware				1,339			1,339
Operating Systems Software				397			397
Global Financing*					388		388
Other Revenue						62	62
Total	$ 4,148	$ 4,130	$ 8,292	$ 1,736	$ 388	$ 62	$ 18,756

* Contains lease and loan/working capital financing arrangements which are not subject to the guidance on revenue from contracts with customers.

Revenue by Geography

(Dollars in millions) For the three months ended September 30, 2018:	Total Revenue
Americas	$ 8,853
Europe/Middle East/Africa	5,827
Asia Pacific	4,076

Total	$	18,756

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Notes to Consolidated Financial Statements (continued)

Revenue by Major Products/Service Offerings

(Dollars in millions) For the nine months ended September 30, 2018:	Cognitive Solutions	Global Business Services	Technology Services & Cloud Platforms	Systems	Global Financing	Other	Total Revenue
Solutions Software	$ 9,080	$	$	$	$	$	$ 9,080
Transaction Processing Software	3,946						3,946
Consulting		5,698					5,698
Global Process Services		934					934
Application Management		5,863					5,863
Infrastructure Services			17,188				17,188
Technical Support Services			5,239				5,239
Integration Software			3,106				3,106
Systems Hardware				4,187			4,187
Operating Systems Software				1,225			1,225
Global Financing*					1,188		1,188
Other Revenue						176	176
Total	$ 13,027	$ 12,495	$ 25,533	$ 5,412	$ 1,188	$ 176	$ 57,830

*Contains lease and loan/working capital financing arrangements which are not subject to the guidance on revenue from contracts with customers.

Revenue by Geography

(Dollars in millions) For the nine months ended September 30, 2018:	Total Revenue
Americas	$ 26,772
Europe/Middle East/Africa	18,410
Asia Pacific	12,648
Total	$ 57,830

Remaining Performance Obligations

The remaining performance obligation (RPO) disclosure provides the aggregate amount of the transaction price yet to be recognized as of the end of the reporting period and an explanation as to when the company expects to recognize these amounts in revenue. It is intended to be a statement of overall work under contract that has not yet been performed and does not include contracts in which the customer is not committed, such as certain as-a-Service, governmental, term software license and services offerings. The customer is not considered committed when they are able to terminate for convenience without payment of a substantive penalty. The disclosure includes estimates of variable consideration, except when the variable consideration is a sales-based or usage-based royalty promised in exchange for a license of intellectual property. Additionally, as a practical expedient, the company does not include contracts that have an original duration of one year or less. Remaining performance obligation estimates are subject to change and are affected by several factors, including terminations, changes in the scope of contracts, periodic revalidations, adjustment for revenue that has not materialized and adjustments for currency.

At September 30, 2018, the aggregate amount of the transaction price allocated to RPO related to customer contracts that are unsatisfied or partially unsatisfied was $119 billion. Given the profile of contract terms, approximately 60 percent of this amount is expected to be recognized as revenue over the next two years, approximately 35 percent between three and five years and the balance (mostly Infrastructure Services) thereafter.

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Notes to Consolidated Financial Statements (continued)

Revenue Recognized for Performance Obligations Satisfied (or Partially Satisfied) in Prior Periods

For the three and nine months ending September 30, 2018, revenue was reduced by $25 million and $50 million, respectively, for performance obligations satisfied (or partially satisfied) in previous periods mainly due to changes in estimates on percentage-of-completion based contracts. Refer to pages 14 and 15 for additional information on percentage-of-completion contracts and estimates of costs to complete.

Reconciliation of Contract Balances

The following table provides information about notes and accounts receivables-trade, contract assets and deferred income balances:

(Dollars in millions)	At September 30, 2018	At January 1, 2018 (as adjusted)
Notes and accounts receivable-trade (net of allowances of $310 and $297 at September 30, 2018 and January 1, 2018, respectively)	$ 7,071	$ 8,295
Contract assets (1)	510	557
Deferred income (current)	10,704	11,493
Deferred income (noncurrent)	3,507	3,758

(1) Included within prepaid expenses and other current assets in the Consolidated Statement of Financial Position.

The amount of revenue recognized during the three months ended September 30, 2018 that was included within the deferred income balance at July 1, 2018 was $3.8 billion and primarily relates to services and software.

The amount of revenue recognized during the nine months ended September 30, 2018 that was included within the deferred income balance at January 1, 2018 was $8.0 billion and primarily relates to services and software.

Deferred Costs

(Dollars in millions)	At September 30, 2018
Capitalized costs to obtain a contract	$ 681
Deferred costs to fulfill a contract:	
Deferred setup costs	2,123

Other deferred fulfillment costs		2,003
Total deferred costs (1)	$	4,808

(1) Of the total, $2,227 million is current and $2,581 million is noncurrent. Prior to January 1, 2018, the current and noncurrent balance of deferred costs were included within prepaid expenses and other current assets and investments and sundry assets, respectively.

On January 1, 2018, in accordance with the transition guidance, $737 million of in-scope sales commissions that were previously recorded in the Consolidated Statement of Earnings were capitalized as costs to obtain a contract.

The amount of total deferred costs amortized during the quarter ended September 30, 2018 was $929 million. There were no material impairment losses incurred during the period. Refer to page 17 for additional information on deferred costs to fulfill a contract and capitalized costs of obtaining a contract.

Transition Disclosures

In accordance with the modified retrospective method transition requirements, the company will present the financial statement line items impacted and adjusted to compare to presentation under the prior GAAP for each of the interim and annual periods during the first year of adoption of the new revenue standard. The following tables summarize the impacts as of and for the three and nine months ended September 30, 2018. The impacts to adjust to prior GAAP are primarily the result of the transition adjustments recorded at adoption. Current period impacts were not material. Refer to note 2, Accounting Changes, for additional information on the transition adjustments.

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Notes to Consolidated Financial Statements (continued)

Consolidated Statement of Earnings Impacts

(Dollars in millions except per share amounts) For the three months ended September 30, 2018:	As reported under new revenue standard	Adjustments to convert to prior GAAP	Adjusted amounts under prior GAAP
Revenue	$ 18,756	$ 4	$ 18,760
Cost	9,953		9,953
Gross profit	8,803	4	8,807
Selling, general and administrative expense	4,363	(28)	4,335
Income from continuing operations before income taxes	2,996	33	3,029
Provision for/(benefit from) income taxes	304	8	313
Net income	$ 2,694	$ 24	$ 2,718
Earnings/(loss) per share of common stock:			
Assuming dilution	$ 2.94	$ 0.03	$ 2.97
Basic	$ 2.95	$ 0.03	$ 2.98

	As reported under	Adjustments to	Adjusted